IOWA UTILITIES BOARD
Energy Section

Docket No.: RMU-2011-0002
Utility: CAPITAL INFRASTRUCTURE INVESTMENT AUTOMATIC ADJUSTMENT MECHANISM FOR RATE-REGULATED NATURAL GAS UTILITIES [199 IAC 19.18]
File Date/Due Date: 7/8/11-1/4/12
Memo Date: 9/2/11

TO: The Board

FROM: Cecil Wright, Bob LaRocca

SUBJECT: Recommending adoption of proposed rule establishing an automatic adjustment mechanism for natural gas utilities, with certain revisions

I. BACKGROUND

On May 5, 2011, the Utilities Board (Board) issued an order commencing a rule making in which the Board proposed to establish a new rule, 199 IAC 19.18, that will allow rate-regulated natural gas utilities to implement automatic adjustment mechanisms for recovery of eligible capital infrastructure investment costs. The proposed rule provides the requirements for two separate automatic adjustment mechanisms. The proposed rule was published in the Iowa Administrative Bulletin (IAB) at IAB Vol. XXXIII, No. 24 (6/1/11) p. 1636, as ARC 9529B.

Initial written comments addressing the proposed rule were filed by MidAmerican Energy Company (MidAmerican), the Consumer Advocate Division of the Department of Justice (Consumer Advocate), Interstate Power and Light Company (IPL), and Black Hills/Iowa Gas Utility Company, LLC, d/b/a Black Hills Energy (Black Hills Energy). On July 8, 2011, the Board conducted an oral presentation for interested persons to make oral comments concerning the proposed rule and to allow the Board to ask questions about the written comments. MidAmerican, Consumer Advocate, IPL, Black Hills Energy, and the American Association of Retired Persons (AARP) appeared, made comments, and responded to Board questions at the oral presentation.

At the conclusion of the oral presentation, the Board stated that a date for additional written comments would be set by Board order. On July 14, 2011, the Board issued an order allowing for additional comments.

Additional comments were filed by MidAmerican, IPL, and Consumer Advocate. On July 29, 2011, Ag Processing Inc. (AGP) filed a statement of position concerning the proposed rule.

Staff summarized the initial comments for the oral presentation in a memo dated June 30, 2011. In this memo, staff has added a summary of the additional comments and comments from the oral presentation to the summary in the June 30, 2011, memo. Staff has not summarized the oral comments separately where those comments are reflected in the written comments.

As pointed out in the June 30, 2011, memo, staff is using the proposed rule that was published in the IAB which may be somewhat different then the proposed rule in the Board's May 5, 2011, order. Each section of the proposed rule has a separate staff analysis and a space for Board comments and signature lines. This allows the Board the opportunity to approve revisions to the adopted rule in section by section. A complete version of the proposed rule with staff's recommended revisions is attached for reference.

II. PROPOSED RULE

Staff still has concerns about the scope of the proposed rule that would allow for automatic adjustment mechanisms other than those that meet the criteria in paragraph "a." The criteria in paragraph "a" are the same criteria that are in the electric service rules and these are the same criteria that the Board has considered in determining whether to approve the automatic adjustment mechanisms proposed by Black Hills Energy and its predecessor. As discussed under the separate provisions of the rule below, the utilities have attempted in this rule making to expand the scope of eligible capital infrastructure investment under paragraph "b" well beyond what the Board considered reasonable in the last Black Hills Energy general rate case. Consumer Advocate, AGP, and AARP have raised concerns about the automatic adjustment mechanism in paragraph "b" that staff has previously discussed with the Board.

In this memo, staff has addressed the separate provisions with the understanding that the Board is interested in establishing criteria for an automatic adjustment mechanism that specifically addresses unplanned investments made because of some government action. Staff's recommended revisions are based upon the understanding that the Board considers such a rule important;, if the Board is not convinced that an automatic adjustment mechanism as proposed in paragraph "b" should be adopted, then staff recommends that the Board adopt paragraph "a" and not adopt paragraph "b."

A. General Comments

1. IPL states that it generally endorses the creation of alternative recovery mechanisms such as those described in the proposed rule. IPL states that such mechanisms may provide more efficient regulation and reduce costs to customers by taking unneeded regulatory costs out of the process. IPL states that it agrees that a utility's response to requirements beyond the utility's control that increase underlying costs is a crucial example of expenses eligible for automatic recovery. IPL states that the automatic adjustment mechanisms should come with appropriate oversight by the Board to ensure procedures are operating as intended and that both a utility's shareholders' and customers' needs are being appropriately addressed.

IPL states that the Board should consider the potential customer impacts of the proposed rate recovery system being proposed. IPL suggests that applying the proposed automatic adjustment mechanisms recovery on a volumetric basis could result in unintended impacts on large users that are not supported by cost of service studies. IPL suggests it may be preferable to either maintain the current rate designs or implement a fixed surcharge amount. In the former case, different classes of customers may pay differing amounts per therm, but this is consistent with underlying cost allocation principles. IPL states that it is not in a position to implement an automatic adjustment mechanism as proposed at this time, so it is not sure if the rate design issue is significant.

2. MidAmerican suggests that recovery of only capital investments is unduly limiting. MidAmerican states that many of the safety-related projects that will result from new government rules or mandated risk assessment processes will have significant operating and maintenance cost impacts. MidAmerican suggests that the Board expand the recovery under the automatic adjustment mechanisms to allow for inclusion of operations and maintenance projects.

In the additional comments, MidAmerican states that, according to the American Gas Association, federal and state regulators throughout the country are looking at new regulatory models and rate designs that provide for more timely recovery of prudently incurred safety and reliability investments. Recent incidents have focused on the need for additional investment to maintain safety and reliability of the distribution network.

MidAmerican states that the Pipeline and Hazardous Materials Safety Administration (PHMSA) has emphasized the need for increased identification, repair, and rehabilitation of high risk pipeline infrastructure and this will impose extraordinary requirements on natural gas utilities. These extraordinary requirements support the need for automatic adjustment mechanisms similar to the ones proposed by the Board. MidAmerican believes that supplementing the rate making process with the automatic adjustment mechanisms would be good

policy. Adoption would eliminate unnecessary rate case expense and assist utilities in expeditiously meeting health and safety requirements.

MidAmerican states that the costs that would be recovered through the automatic adjustment mechanisms are beyond the control of management and so regulatory lag cannot induce efficiencies for these costs. MidAmerican suggests that without the automatic adjustment mechanisms there will be more frequent rate cases.

In response to comments from AARP at the oral presentation, MidAmerican states that recovery of costs through an automatic adjustment mechanism may provide a utility with the resources to help ensure early adoption of reliability and safety requirements which would enhance the health, safety and welfare of customers. MidAmerican suggests that the proposed automatic adjustment mechanisms are an appropriate way to recovery prudent costs that benefit public health and safety.

MidAmerican states that it supports using normalized sales volumes from the latest PGA filing for purposes of the automatic adjustment mechanism.

MidAmerican states that it supports the Consumer Advocate suggestion that eligible costs be readily, precisely, and continuously segregated into accounts of the utility.

MidAmerican states that there should not be disincentive for utilities to size pipe for future growth if this makes economic sense. Prudent upgrades should not be discouraged. MidAmerican states that there are several benefits to designing pipe upgrades for future growth. These are:

(1) Significantly lower future incremental construction costs.

(2) Reduced footage of pipe ultimately installed, maintained and operated.

(3) Less opportunity for interruption of infrastructure such as street closures.

(4) Potentially reduce the time to be able to add new load.

(5) Less congestion in crowded utility corridors.

MidAmerican suggests that calculations of incremental safety enhancement costs versus incremental load costs would involve a speculative

allocation of costs. In addition, customers benefit when pipe is sized that results in efficient overall investment.

MidAmerican states that operation and maintenance (O&M) costs can be segregated and tracked by project. MidAmerican states that O&M costs to be recovered through an automatic adjustment mechanism would be for replacement and substantial modification of significant portions of the system and not existing facilities.

MidAmerican states that as a general principle it has no objection to offsetting costs by O&M cost savings. MidAmerican expressed two caveats to this principle: (1) savings must be reasonably expected to occur as a direct result of the investments; and (2) the nature of the costs to be recovered makes it likely that savings will be minimal.

MidAmerican states the proposed limitations on availability of the automatic adjustment mechanisms suggested by Consumer Advocate are not necessary or advisable. MidAmerican states that utilities agree to rate freezes because the utility believes it can control costs during the freeze. The costs to be recovered through the automatic adjustment mechanisms would be beyond a utility's control and would not be affected by a rate freeze. MidAmerican argues that there is no compelling reason to adopt a rule that restricts how future settlements are crafted. In addition, a requirement that a utility have a rate case within three years, thus requiring a utility to file a rate case to be eligible to have an automatic adjustment mechanism, appears to be at odds with the Consumer Advocate position that regulatory lag is beneficial.

MidAmerican believes there is no risk shifting that need to be addressed if an automatic adjustment mechanism is adopted. The utility's risk increases when it has prudent costs beyond its control and the automatic adjustment mechanism merely removes that additional risk. The suggestion that risks have been shifted to the ratepayer would only be true in the case where the regulatory agency does not review the costs for prudence. Whether costs are recovered in the course of a general rate case, or through some automatic adjustment mechanism, the business risk of establishing prudence remains with the utility.

MidAmerican states that no perverse incentive would be created since the utility does not have a choice over the programs implemented, the timing of those programs, or the related costs. The costs imposed are significant costs imposed upon MidAmerican with a defined implementation schedule that is largely beyond the control of the utility. There is little opportunity to game the system.

Anticipated federal rules are:

(1) Expanding the definition of High Consequence Areas (HCAs) to included transmission pipe.

(2) Pressure testing transmission pipe that has maximum allowable operating pressures that were not established by pressure test.

(3) Installing remotely-operated isolation valves on HCAs.

(4) Increased recordkeeping requirements.

(5) Increased reporting requirements.

(6) Requiring/encouraging more assessments to be completed by in-line inspection tools.

(7) Increased requirements for direct assessment procedures.

(8) Mandatory installation of excess flow valves.

(9) Distribution pipe replacements, increased requirements for utilities to manage compression couplings.

(10) Increased documentation of system monitoring and analysis under Distribution Integrity Management.

(11) Implementation of various distribution risk mitigation measures.

(12) Enhanced public awareness requirements including notifications and training.

(13) Enhanced third-party damage mitigation programs consistent with the Damage Prevention Assistance Program (DPAP).

(14) Increased documentation and procedures resulting from the Control Room Management Program.

(15) Increased physical and cyber security requirements in accordance with the Transportation Security Administration.

(16) Expansion of operator qualifications to construction critical tasks.

(17) Increased operator qualification training requirements.

In response to a question about an earnings trigger, MidAmerican states that it does not believe that a trigger is necessary. MidAmerican states that cost trackers are historically allowed to avoid the possibility of a utility suffering serious financial harm. A utility should not have to show dire financial hardship before implementing an automatic adjustment mechanism. The mechanism should only require that the utility is experiencing extraordinary expense outside of the utility's control.

Any trigger would only focus on a moment in time and natural gas utility returns are influenced by a number of variables, primarily weather. Implementation of a trigger would place an artificial restriction on the use of automatic adjustment mechanisms and be contrary to the goal of such a mechanism. Looking backwards to historical returns suggests retroactive ratemaking in which future earnings would be impacted by safety investments. If this approach is adopted, then the Board should allow future rate increases to offset past low utility earnings.

3. Black Hills Energy states that infrastructure or integrity investment automatic adjustment mechanisms have been found to be acceptable to assist utilities in investing in integrity and safety projects. Black Hills Energy states that these mechanisms ensure that investments for system safety and integrity are made timely and can aid in making general rate cases less frequent. Black Hills Energy states that these types of recovery mechanisms do not violate the matching principle since the investments do not lead to new revenue sources that could help recover the costs.

Black Hills Energy states that PHMSA recently issued distribution integrity management programs (DIMP) rules for local distribution companies. Under the new rules, local distribution companies are required to identify system threats, analyze risks and mitigate the applicable threats and integrity concerns. Black Hills Energy suggests that utilities may have to increase expenditures to meet these new requirements.

Black Hills Energy included Attachment 1 from the American Gas Association's May 2011 Report on Infrastructure Cost Recovery Mechanisms. Black Hills Energy also provided projected effect of the proposed rule.

Black Hills Energy states that it has budgeted $8.7 million for 2011 non-revenue producing capital investments. Black Hills Energy estimates that approximately $6.685 million would qualify for recovery under the proposed rules, as either safety-related investments or government mandated line relocations. Black Hills Energy lists the following investments as being eligible for recovery:

City, State, Federal Main Replacements	$1,687
Main Rehab	$1,051
Main Replacements, Blanket/Other	$378

Service Line Replacements	$2,586
Meter Set Replacements	$279
Final Retirements	$318
TBS, DRS, Odorizer, SCADA Equipment	$386
Total	**$6,685**

Black Hills Energy calculates the carrying charges based upon a cost of debt of 8.04 percent and a depreciation rate of 1.18 percent to be approximately $621,739. Black Hills Energy calculates the customer impact from this carrying charge. Black Hills Energy suggests two changes in the calculation of the customer rates. First, the carrying charges should be shared pro-rata among all ratepayers. Second, the charges should be calculated using the rate design approved by the Board in the company's last rate case instead of a purely volumetric charge. If a volumetric charge is used, Black Hills Energy suggests using the normalized volumes from a utility's most recent PGA, rather than requiring a separate calendar year normalization calculation. Black Hills Energy provides its calculations of both methods of calculating rates in its comments on page 8.

4. Consumer Advocate opposes the proposed rules because a need has not been shown to justify an automatic adjustment mechanism as proposed. Consumer Advocate points out that the three rate regulated utilities have filed only seven rate cases in last ten years: one by MidAmerican, two by IPL, and four by Black Hills Energy and its predecessors.

Consumer Advocate states that automatic adjustment mechanisms should be limited in use since they create a serious ratemaking problem of the mismatch between revenues and expenses. This mismatch reduces the incentives for a utility to operate efficiently. Consumer Advocate stresses that the matching principle is an important regulatory tool that is distorted by use of trackers such as those proposed. Matching the changes in revenues with changes in costs allows a utility to cover increases in costs with increases in revenue and allows utility management to reduce controllable costs to offset other cost increases. Adoption of an automatic adjustment mechanism for certain costs removes this matching and will influence the regulatory process in favor of the utility.

Consumer Advocate states that automatic adjustment mechanisms (1) have an adverse impact upon management incentives to control costs; (2) shifts the risk of cost increases to customers without adequately recognizing the risk reduction when setting base rates; (3) are difficult to audit; and (4) are difficult to track because of complex accounting entries and accelerated procedural schedules.

Consumer Advocate argues that automatic adjustment mechanisms generally benefit shareholders since they reduce regulatory lag which reduces the incentive to control costs. Regulatory lag promotes efficiencies that benefit

both customers and shareholders by replacing some of the competitive market efficiencies that are not present with cost of service regulation. Regulatory lag encourages utilities to seek out ways to increase productivity and reduce costs. Consumer Advocates states that these efficiencies should be encouraged.

In its additional comments, Consumer Advocate states that at the oral presentation it expressed its position that automatic adjustment clauses like the ones proposed in this rule making are not currently needed. This is evidenced by the few general rate proceedings filed by rate-regulated natural gas utilities over the past decade. In addition, two of the rate regulated utilities appear to be earning more than the rate of return authorized by the Board.

Consumer Advocate suggests that a utility should only be authorized to implement an automatic adjustment mechanism if: (1) the utility is currently earning a return on common equity that is well below the common equity return approved by the Board in the utility's most recent general rate proceeding; (2) there are no offsetting revenue increases or cost savings throughout the utility's natural gas operations and without an automatic adjustment mechanism the utility's return on equity is at least 100 basis points under the rate of equity approved by the Board in the utility's most recent rate decision; and (3) the automatic adjustment mechanism would not cause the utility's actual earned return on equity to exceed the common equity return approved by the Board in the utility's most recent general rate proceeding.

Without the showing described above, Consumer Advocate suggests that it would be unfair to customers to increase rates automatically. Consumer Advocate is opposed to expanding the automatic adjustment mechanism to include operation and maintenance expense. This expansion would go beyond the intent of the proposed rule and would create many more matching problems. Consumer Advocate argues that allowing these additional costs to be recovered without offsetting costs already in rate base could lead to double recovery.

Consumer Advocate does not agree that general rated case proceedings are to be avoided. Consumer Advocate argues that the single most important consumer protection that rate regulation provides is a general rate case proceeding. Establishment of automatic adjustment mechanisms would short circuit the protections provided consumers by periodic rate proceedings.

5. AGP states that it is a cooperative that processes soybeans in plants located in Mason City, Sheldon, Sgt. Bluff, Manning, Eagle Grove, and Emmetsburg, Iowa. AGP states that it is owned by 250,000 farmers and is the largest cooperative soybean processing company in the world. AGP states that it receives natural gas service from both MidAmerican and IPL.

AGP is concerned that automatic adjustment mechanisms will allow utilities to perform single or piecemeal ratemaking which will benefit the utility and

not ratepayers. AGP states that it intervenes in ratemaking dockets because the cost of energy at its plants is a primary operating cost. AGP states that as an industrial customer it does not always agree with the positions taken by Consumer Advocate. However, in this instance AGP supports Consumer Advocate's comments and provides some additional comments.

With a limited budget, AGP cannot participate in all ratemaking cases and allowing MidAmerican and IPL to implement an automatic adjustment mechanism will make participation that much more difficult. AGP states that it is not clear how many automatic adjustment proceedings AGP will have to intervene in each year in addition to any general rate proceedings. Having to participate in an increased number of proceedings will be burdensome. AGP states that moving cost elements out of general rate proceedings into automatic adjustment dockets reduces the ability of customers to participate in the regulatory process. Since the regulatory process is a substitute for competition in the market, setting prices through an automatic adjustment mechanism without customer participation may erode customer confidence in the rates and the regulatory process.

6. AARP provided oral comments at the oral presentation but did not file initial written comments or additional written comments. At the presentation, AARP stated that it represented older Iowans who were energy customers and that it opposed the proposed rule. AARP stated that the statutes required that companies provide reliable service at fair rates and allowing automatic adjustment mechanisms did not serve customer interests. AARP stated that allowing companies to use automatic adjustment mechanisms undermined the comprehensive review of company operations that occur in rate cases and singles out certain costs for recovery which will increase rates to customers. AARP stated that only shareholders benefit from automatic adjustment mechanisms. Automatic adjustment mechanisms shift costs from shareholder to ratepayers and if approved should include a reduced return on equity. AARP cited to the NRRI study that showed the disadvantages of automatic adjustment mechanism and found there were positive effects of regulatory lag.

B. Specific Comments

199—19.18(476) Capital infrastructure investment automatic adjustment mechanism.

19.18(1) Eligible capital infrastructure investment. A rate-regulated natural gas utility may file for board approval a capital infrastructure investment automatic adjustment mechanism to allow recovery of certain costs from customers. To be eligible for recovery

through the capital infrastructure investment automatic adjustment mechanism, the costs shall either:

a. Meet the following criteria:

(1) The costs are beyond the direct control of management;

(2) The costs are subject to sudden, important change in level; and

(3) The costs are an important factor in determining the total cost of capital infrastructure investment to serve customers; or

1. Consumer Advocate suggests that the criteria in 19.18(1)"a" and "b" should be combined so that the utility would have to meet all of the criteria before an automatic adjustment mechanism would be approved. This would remove the possibility that a utility could have an automatic adjustment mechanism approved under paragraph 19.18(1)"b" that would not meet the long standing criteria for an automatic adjustment mechanism reflected in paragraph 19.18(1)"a."

Under the Consumer Advocate proposal an automatic adjustment mechanism would have to meet the requirement that the costs being recovered represent a significant portion of the utility's overall cost of service. Consumer Advocate states if the costs are not significant then ratepayers would be better served by requiring the utility to wait until the next rate case to recognize the costs and all other costs and revenue items. The focus of the proposed rule is too narrow since it addresses only the cost of certain capital infrastructure investments instead of the magnitude of the infrastructure investment to be recovered between rate cases in relation to the utility's total revenue requirement.

Consumer Advocate also suggests adding an additional criteria as paragraph 19.18(1)"a" which provides that the costs "are readily, precisely, and continuously segregated in the accounts of the utility." Consumer Advocate states that this suggested change is important because it ensures that the costs can be readily tracked and properly accounted for. This language mirrors a similar requirement in the automatic adjustment rules for electric utilities.

Consumer Advocate is also suggesting the phrase "required for safety" be deleted from the requirements in 19.18(1)"b" because it is undefined and open to interpretation. This will make the requirement difficult be uniformly applied. Consumer Advocate states that safety related investment will still be recovered

when they meet clearly defined and easily verifiable criteria set forth in federal and state gas pipeline safety regulations.

Staff Analysis

Staff does not recommend the Board adopt the suggested changes to this subrule that would require a utility to meet all of the requirements in paragraphs "a" and "b" in order to implement an automatic adjustment mechanism. Paragraph "a" reflects the current standard applied by the Board in the Black Hills Energy rate case and the standard in the electric rules. This standard has been applied historically to automatic adjustment mechanisms proposed by utilities. By including paragraph "a" in the proposed rule, the Board is making the natural gas rules consistent with the electric rules and formalizing the traditional standard. Since there is no disagreement by the parties, staff recommends the Board revise paragraph "a" by adding the fourth criterion suggested by Consumer Advocate. The criterion is as follows:

(4) The costs are readily, precisely, and continuously segregated in the accounts of the utility.

Paragraph "b" is proposed to address a specific concern that the Board recognized from the Black Hills Energy case. This concern was that natural gas utilities are required to make infrastructure investment for which the utility has not planned because of government mandates or to comply with federal natural gas pipeline safety requirements. Separate criteria were proposed for a paragraph "b" automatic adjustment mechanism since eligibility for recovery will be restricted and it is very likely that the costs to be recovered will not reach the criterion of being an important cost in providing service to customers. It is staff's understanding that the Board considered these types of investments significant enough to warrant recovery through an automatic adjustment mechanism.

Board Approval and/or Comments

APPROVED

/s/ Elizabeth S. Jacobs *9-8-11*
Date

/s/ Darrell Hanson *9-9-11*
Date

/s/ Robert B. Berntsen *9-7-11*
Date

b. Be costs for a capital infrastructure investment which:

(1) Do not serve to increase revenues by directly connecting the infrastructure replacement to new customers;

(2) Is in service but was not included in the gas utility's rate base in its most recent general rate case; and

(3) Replaces or modifies existing infrastructure required by state or local government action, is required for safety, or is required to meet state or federal natural gas pipeline safety regulations that become effective after January 1, 2011.

1. MidAmerican states that MidAmerican anticipates major safety-related infrastructure costs to be related to the replacement of existing assets, the costs may be accounted for as maintenance expense instead of capital additions. In addition, certain asset replacement costs will not qualify as capital if the asset is not a unit of property. Expenditures associated with programs such as Gas Distribution or Transmission Integrity Management Plans have both operations and maintenance and capital cost components. MidAmerican states projects that include both classifications of expenditures should be eligible for recovery under the adjustment mechanism. MidAmerican suggests the Board expand the eligible costs to allow for the inclusion of operations and maintenance projects. MidAmerican suggests a minimum threshold could be established to limit recovery of operations and maintenance expense to those projects with cost of a minimum of $100,000 per project. MidAmerican states that inclusion of operations and maintenance cost recovery would not be as straightforward as recovery of just capital investment alone, the eligible costs could be included in an over/under collected account similar to the PGA.

MidAmerican states that other projects which could be included in the operations and maintenance cost recovery would be: (1) internal inspections with a "smart" pig, (2) pressure testing, and (3) direct assessment testing required under the transmission integrity requirements. Another example would be the potential of having to reestablish pipelines' maximum allowable operating pressure of pre-1971 pipe by pressure test.

MidAmerican states that the scope of the type of costs that could be recovered under the proposed rule, "replace or modify existing infrastructure required by state or local government action" or "are required for safety" is quite broad. MidAmerican suggests further refining the definition and clarification of the types of costs which are eligible. MidAmerican suggests that costs related to infrastructure projects included in Gas Distribution or Transmission Integrity Management Plans, projects resulting from incident investigations such as San Bruno, California, and projects related to Pipeline and Hazardous Material Safety Administration (PHMSA) safety advisories should be eligible for inclusion. MidAmerican suggests the following categories as examples of expenditures that should be eligible for inclusion in the proposed automatic adjustment mechanism:

System Reliability projects

- Looping feeder/mains for pressure improvements
- Pressure uprating

Main/service replacements/rehabs

- Cast and wrought iron
- Pipe that cannot be cathodically protected
  - Bare steel
  - Non-continuous steel
- 1st generation plastic

Systematic replacement of obsolete equipment

- Meters
- Regulators/reliefs
- Regulator stations
- Odorizers
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In additional comments, MidAmerican states that recovery under an automatic adjustment mechanism should not be limited to capital costs. MidAmerican states that some of the costs to comply with new governmental rules may be accounted for as operating and maintenance costs, rather than capital costs. MidAmerican suggests that the focus of the rule should be on projects and not on the type of costs that may be recovered.

In response to a question from the Board about the categories listed above, MidAmerican states in its additional comments that it is impossible to know all of the categories that could be included since government mandated safety requirements are expected to continue to expand. MidAmerican states that it currently expects three main categories of projects:

1. System reliability projects;

2. Main and service rehabilitation projects; and

3. Systematic replacement of obsolete equipment will be required to meet proposed Transmission Integrity Management Plans (TIMP), Distribution Integrity Management Plans (DIMP), and PHMSA requirements.

2. Black Hills Energy supports this proposed subrule with a suggested modification. Black Hills Energy suggests the insertion of the phrase "directly or primarily" into the first sentence of 19.18(1)"b." The suggested language would read as follows: "Are costs which do not serve to directly or primarily increase revenues by directly connecting the infrastructure replacement to new customers."

Black Hills Energy states that the suggested additional phrase would address those costs that are incurred when the utility replaces a smaller pipe with a larger pipe in the anticipation of future growth. This makes good business sense and is cost effective since the utility would not have to come back and replace the pipe in 2 to three years.

Staff Analysis

It is staff's understanding that the automatic adjustment mechanism criteria proposed in paragraph "b" are designed to allow recovery of capital infrastructure investments only as a way to reduce regulatory lag for these investments that are the result of local, state, or federal governmental action or because of state or federal safety regulations. By limiting the recovery under the automatic adjustment mechanism to these specific investments, the utility will not have to go through a long proceeding to consider a proposed automatic adjustment mechanism but can just file a tariff for Board approval. Staff believes that any expansion beyond the capital infrastructure investment costs proposed to be recovered through a paragraph "b" mechanism would require staff and Consumer Advocate to spend additional time and resources to review the costs and potentially could lead to the suspension of the tariff and conducting a mini-rate case proceeding. Costs such as operation and maintenance expenses would have to be verified and, where there were questions about the connection between the expenses and government action, the time for review would likely be extended beyond 30 days.

Expenses are costs that are recovered through rates on a dollar for dollar basis and the amount of recovery in current rates reflects the level of expenses that a utility is likely to incur overall. Any increases in operation and maintenance expenses due to compliance with safety regulations could be offset by cost savings in other expense areas. Staff believes a review to determine the proper level of operation and maintenance expenses is best left to general rate proceedings where offsetting savings can also be considered.

In addition, staff is not convinced that inclusion of O&M expenses would be in the best interest of rate payers. MidAmerican and IPL have not been in for rate cases since 2002 and 2005, respectively, and so seem to have been able to maintain their systems with the rates now in effect. Black Hills Energy seems determined to come in every two years regardless of the current rates. There does not seem to be a need to expand recovery for these companies beyond what has been proposed to address capital infrastructure investment caused by government action or federal safety regulations.

Staff is not sure that the language proposed by Black Hills Energy is necessary to address the issue raised by Black Hills Energy. If the capital infrastructure investment is limited to the eligibility requirements in paragraph "b," then the decision of the utility to size the replacement pipe larger than the replaced pipe should not be an issue as long as the increased diameter is for some future increase in customer growth and not for new customers that will be ready to attach to the system at the time construction is completed. If there is a question about the sizing of a replacement pipeline, then the utility will need to explain why the increased size is necessary and show that it is not for current customer growth. Staff believes requiring the utility to explain the need for the additional pipe size is a more appropriate way to address this issue rather than include the language, "directly or primarily," as proposed. Even with the new phrase, if questions arise about the size of replacement pipe, the utility will need to explain the need for the increased size of the pipe.

Staff does agree that the phrase "required for safety" in 19.18(1)"b"(3) is vague and it may be redundant with the following phrase "or is required to meet state or federal natural gas pipeline safety regulations" and staff believes deleting the phrase may be a better solution than attempting to define what the phrase means. Staff recommends deleting the phrase.

Staff is also recommending deleting the date limitation, "that become effective after January 1, 2011," in 19.18(1)"b"(3). Comments indicated this may prevent recovery of some investment that should otherwise be eligible. As long as recovery is limited to capital infrastructure investment required by federal regulations, the date a federal regulation is adopted may not be significant.

Finally, staff is concerned that Black Hills Energy, from its initial comments, may consider all of the capital investments that it listed in its initial comments to be eligible for recovery under a paragraph "b" automatic adjustment mechanism. Staff does not believe that the Board proposed the rule for an automatic adjustment mechanism to allow Black Hills Energy to do through an automatic adjustment mechanism rule making what the Board would not allow Black Hills Energy to accomplish in the past three general rate cases. The issue of the utilities' attempts to include in this rule provisions that would allow for the recovery of items that staff believes are not suitable for recovery outside of a general rate proceeding is one of the primary concerns that staff has had with the

automatic adjustment mechanisms proposed by Black Hills Energy in previous cases. This problem is highlighted by the list of items that Black Hills Energy argues should be included for recovery under this rule making.

Staff believes the Board should make it clear to Black Hills Energy, and the other utilities, that of the items listed by Black Hills Energy only "City, State, Federal Main Replacements," appear to meet the requirements of paragraph "b" and for the process to work as intended the other items listed (Main Rehab, Main Replacements, Blanket/Other, Service Line Replacements, Meter Set Replacements, Final Retirements, and TBS, DRS, Odorizer, SCADA Equipment) are not the types of investments that are intended to be included for recovery in the automatic adjustment mechanism in paragraph "b."

Board Approval and/or Comments

I agree with Staff's recommendation. I would add, however, that the tracker mechanism for these "section b" expenses should be done on a pilot project basis for 3 to 5 years. This will allow the Board to evaluate the success/challenges associated with it and decide at a later date whether to make "section b" permanent. "Section a" does not need to be done on a pilot project basis as it simply reflects the current status of the law. RBB

Overall I agree with staff's recommendation but concur with Rob. Whether this is done as a pilot project for section b, or we sunset section b in 4 years, is the approach to use. Sunsetting would allow us to relook and fine tune down the road, without being permanent. LJ

I also agree, although there will need to be some thought given to how the sunset works. Do all section b trackers end after 4 years (in 2010) or is the 4-year mark the latest that a section b tracker can be implemented? If annual filings are required, I prefer the former. DRH 9-9-11

APPROVED

/s/ Elizabeth S. Jacobs *9-8-11*
Date

/s/ Darrell Hanson *9-8-11*
Date

/s/ Robert B. Berntsen *9-7-11*
Date

19.18(2) Determination of recovery factor. The utility may recover a rate of return and depreciation expense associated with eligible capital infrastructure investments described in subrule 19.18(1). The allowed

rate of return shall be the average cost of debt from the utility's last general rate review proceeding. Depreciation expense shall be based upon the depreciation rates allowed by the board in the utility's last general rate review proceeding.

1. IPL suggests that the defined rate of return may be too low. IPL proposes that the appropriate rate of return would be the last approved weighted average rate of return applied in the last contested case proceeding before the Board.

IPL filed additional comments that stated there should be a recovery of a return on investments that were eligible for the proposed automatic adjustment mechanisms. IPL points out that all three of the utilities that filed initial comments agreed that some level of return on investment should be recovered through the automatic adjustment mechanism. IPL points out that the fact that no current automatic adjustment mechanisms approved by the Board allows recovery of a return on collections is a diversion since no current automatic adjustment mechanism allows recovery of capital asset investment that would otherwise be rate-based. IPL suggests that allowance for funds used during construction is a better example for comparison.

IPL states its agreement with MidAmerican that the types of investments to be recovered through the proposed automatic adjustment mechanisms are usually placed in rate base and would earn a return. It is only logical then that investments under the investments should earn a return under the automatic adjustment mechanism. The investments can then be considered for inclusion in rate base in the next general rate proceeding and, if approved, rolled into the utility's rate base and earn the authorized rate of return.

IPL states that the comments show that there is a debate about the level of return that should be applied under the automatic adjustment mechanism. IPL states that whichever return is adopted should not affect the utility's overall risk profile. Without a return on the investments under the automatic adjustment mechanism, the utility might file a general rate case proceeding sooner than the utility would otherwise to begin earning a return on the investment. IPL states that the investments would probably be recovered in the rate case and allowance of a return under the automatic adjustment mechanism does not make the investment any more or less risky. If a return is allowed, it should delay a general rate case.

Additionally, IPL states that no limitations are needed with regard to implementation of an automatic adjustment mechanism. IPL opposes the limitation suggested by Consumer Advocate that utility's subject to a rate freeze not be given an automatic adjustment mechanism and a utility could not have an automatic adjustment mechanism if the utility had not filed a general rate case

proceeding within three years. IPL states that the criteria proposed by the Board will limit a utility's use of an automatic adjustment mechanism and that further limitations are not necessary. The Board also has continuing oversight of the automatic adjustment mechanisms and can object to any item that the utility proposes to include for recovery.

Finally, IPL states that from a practical stand point the Consumer Advocate suggestion to reduce automatic adjustment mechanism recovery by estimated operations and maintenance (O&M) savings is not workable. It would be hard to track the savings to the expenditure and the estimation of any savings would be difficult. Even in a general rate proceeding such a calculation would be difficult and requiring calculation of savings in an automatic adjustment mechanism filing might not be cost effective since the savings very likely will be minimal.

2. MidAmerican suggests the more appropriate rate of return would be the overall rate of return established in the last general rate proceeding. MidAmerican states that the types of capital investment proposed to be recovered are those that have typically been accepted for inclusion in rate base. MidAmerican suggests that once the investment has been placed in service there is no need to deny the utility the overall return on the investment.

MidAmerican requests confirmation that the infrastructure investments eligible for recovery under the proposed rule would be eligible for inclusion in the requesting utility’s next general rate proceeding, with the adjustment mechanism reset when new rates are implemented. MidAmerican requests clarification that the infrastructure costs that are capital additions would be included in rate base at the overall rate of return decided in that proceeding.

In additional comments, MidAmerican urges the Board to change the return on investment from the average cost of debt to the overall rate of return approved by the Board in a utility's last rate case. MidAmerican argues that there is no logical reason to provide a lower return on investments that have been prudently made to increase the safety and reliability of gas service.

3. Black Hills Energy supports this proposed subrule with the understanding that if the average cost of debt or depreciation is not set forth in the last general rate proceeding, the cost of debt and depreciation rate will be as set forth in the last general rate proceeding where they are identified.

4. Consumer Advocate suggests changes to subrule 19.18(2) that delete recovery of a return on the eligible investment. Consumer Advocate states that a utility should only be allowed to recover the depreciation on infrastructure investments which is the return of the capital invested. Consumer Advocates does not support allowing a utility to earn a return on the infrastructure investment through the automatic adjustment mechanism. Consumer Advocate

argues that annual depreciation expense provides adequate protection for shareholders for the investment in infrastructure between rate proceedings. Consumer Advocate points out that none of the other Board approved automatic adjustment mechanisms permit a utility to charge customers a return on the costs included in the adjustment.

Consumer Advocate suggests adding a requirement to 19.18(2) that subtracts operating and maintenance savings estimated to result from the capital infrastructure investments from the costs that are to be recovered. Consumer Advocate states that it is imperative that costs savings be subtracted in calculating the amount to be recovered from customers. Consumer Advocate states since the utility's rate base rates reflect the level of operating and maintenance costs associated with the old infrastructure, the replacement of the old infrastructure is likely to result in some cost savings and these cost savings should be reflected to avoid charging customers for operating and maintenance costs that are included in base rates but will be avoided as a result of the new capital infrastructure investments.

Consumer Advocate also suggests adding a requirement in subrule 19.18(2) that provides:

> In no event shall a utility be allowed to implement a capital infrastructure investment mechanism (1) if the final decision and order in its last general rate case proceeding was issued more than 3 years prior to the filing of the utility's request for approval pursuant to rule 19.18(1) and (2) during the pendency of a board approved rate freeze.

Consumer Advocate states that the above suggested language will prohibit a utility under a rate freeze from implementing a capital infrastructure investment automatic adjustment mechanism during the pendency of the rate freeze. Consumer Advocate states that it would be unreasonable to allow a utility under a rate freeze to recover costs automatically since this would violate the rate freeze agreement.

Finally, Consumer Advocate points out that the proposed automatic adjustment rule differs significantly from the Board's other automatic adjustment mechanism rules in that the proposed rules do not specify the formula to be used in implementing the proposed automatic adjustment mechanism. Consumer Advocate believes that the calculation of the automatic adjustment mechanism should not be left to the utility to determine. Consumer Advocate states that consumers are better protected if there is a uniform and consistent manner of calculation set out in the rule.

Staff Analysis

Staff does not agree with MidAmerican that the costs of capital investment that is recovered through an automatic adjustment mechanism should recover the rate of return from the utility's last rate case. Staff believes that there is a reduced risk for the utility if there is a recovery of capital infrastructure investment between general rate cases. The utility would be receiving a return on investment prior to the inclusion of that investment in rate base. This is money the utility would not otherwise receive. This earlier recovery of a return on investment should be reflected through a lower return on the investment recovered through the automatic adjustment mechanism. Staff believes that the cost of debt from the utility's last rate case reflects this earlier recovery.

In addition, if MidAmerican were to implement an automatic adjustment mechanism, then the rate of return would be from 2002 and would not reflect current economic factors. The rate of return for IPL would be from 2005 and suffer from the same problem. The Black Hills Energy rate of return would be from 2010 and could be considered current. In addition, settlements might not have a stated rate of return, but the settlement should have a cost of debt that was used to develop a revenue requirement.

Staff does not agree with Consumer Advocate that there should not be a recovery of a return on capital infrastructure investment in the proposed automatic adjustment mechanism rule. The purpose of the automatic adjustment mechanism is to provide a mechanism for a utility to recover costs associated with investment that very likely was not planned for in the utility's budget and, within the specific limitations in the rule, that are required by government mandate or for safety. Staff believes that with the specific limitations in the proposed rule that recovery of a return on the eligible investment will make it easier for utilities to meet anticipated federal gas pipeline safety regulations, which is one of the purposes of the proposed rule. Staff believes that allowing only a recovery of depreciation would provide little benefit to the utility and would not provide the needed incentive for the utility to comply expeditiously with government mandates.

Staff does not agree with Consumer Advocate that a utility should have filed a general rate case within three years of the automatic adjustment mechanism, or that the utility not be subject to a rate freeze. One of the potential benefits that should follow adoption of an automatic adjustment mechanism is lengthening the time between rate cases. Staff believes requiring a rate case within three years of implementing an automatic adjustment mechanism would be counter-productive in meeting this goal. Rather than requiring a rate case to have been filed within three years of implementation, the Board may want to consider adding a requirement in the rule that a utility cannot file a new general rate case within three years after the first year an automatic adjustment mechanism is implemented. A three-year in rate case filings would ensure that customers would receive the benefit of reduced rate case expense if an automatic adjustment mechanism is implemented.

Staff also does not consider the limitation that utilities with rate freezes cannot implement an automatic adjustment mechanisms to be reasonable. Rate freezes are usually agreed to as part of a general rate case settlement and staff can see no reason to insert the issue of an automatic adjustment mechanism into those negotiations.

In response to MidAmerican's confirmation request, staff recommends that the Board state that the infrastructure investments eligible for recovery under the proposed automatic adjustment rule would be eligible for inclusion in rate base in the requesting utility's next general rate proceeding. Once the final rates from the general rate case become effective, the automatic adjustment mechanism would be reset to zero. The capital infrastructure investment included in an automatic adjustment mechanism, if included in rate base in the Board's decision, would be included in rate base at the overall rate of return approved in that proceeding.

Board Approval and/or Comments

APPROVED

/s/ Elizabeth S. Jacobs *9-8-11*
Date

Date

/s/ Robert B. Berntsen *9-7-11*
Date

19.18(3) Recovery procedures.

a. To recover capital infrastructure investment costs that meet the criteria in paragraph 19.18(1)"a" through an automatic adjustment mechanism, the utility is required to obtain prior board approval of the automatic adjustment mechanism. The utility shall file information in support of the proposed automatic adjustment mechanism that includes:

(1) A description of the capital infrastructure investment and the costs that are proposed to be

recovered through the automatic adjustment mechanism;

(2) An explanation of why the costs of the capital infrastructure investment are beyond the control of the utility's management;

(3) An exhibit that shows the changes in level of the costs of the capital infrastructure investment that are proposed to be recovered, both historical and projected;

(4) An explanation of why these particular capital infrastructure investment costs are an important factor in determining the total cost of capital infrastructure investment to serve customers;

(5) A description of proposed recovery procedures, if different from the procedures described in paragraphs 19.18(3)"c" and "d";

(6) The length of time that the automatic adjustment mechanism will be in place.

1. MidAmerican requests clarification that approval of an automatic adjustment mechanism under 19.18(3)"a" can be obtained through a stand-alone proceeding outside of a general rate proceeding.

2. Black Hills Energy supports this paragraph.

Staff Analysis

Staff does not have a strong opinion on whether an automatic adjustment mechanism under the proposed rule could be obtained in a stand-alone proceeding. It would be hard for a utility to provide the information necessary for the Board to consider whether to approve the paragraph "a" mechanism outside of a rate case, but if a utility wanted to take that chance, staff is not necessarily opposed. Staff recommends the Board make it clear in the order adopting amendment if the Board will allow stand-alone proceeding. No revisions need made to the rule to address the decision.

Board Comments on whether to allow a stand-alone proceeding.

I am ok with the concept of a "stand-alone" proceeding. RBB 9-7-11

I would allow a "stand-alone" proceeding. LSJ 9-8-11

I agree. DRH 9-9-11

b. Recovery of capital infrastructure investment costs that meet the requirements in paragraph 19.18(1)"b" may be made by the utility by filing annually on or before April 1 of each year a proposed tariff with an effective date of May 1 or later. The utility shall file information in support of the proposed automatic adjustment rates that includes:

(1) The government entity mandate or action that results in the gas utility project and the purpose of the project, or the safety-related reason requiring the project.

(2) The location, description, and costs associated with the project.

(3) The cost of debt and applicable depreciation rates from the utility's last general rate review proceeding.

(4) The calculations showing the total costs that are eligible for recovery and the rates that are proposed to be implemented.

(5) The utility shall provide supporting documentation, including but not limited to work orders and journal entries, to the board staff or the office of consumer advocate upon request.

1. IPL states that it is not clear whether the Board intends to explicitly approve the annual adjustment factors proposed by a utility prior to implementation. If the Board does not intend an upfront approval, IPL questions whether 30 days is sufficient time for the Board to review and approve the recovery factors. If the Board does intend upfront approval, then mirroring the timing for the EECR (Energy Efficiency Cost Recovery) factors may be appropriate. IPL suggests only one annual filing be required which would include both the new factors and the reconciliation. This is consistent with the EECR and IPL's transmission cost recovery rider.

2. MidAmerican requests confirmation that the tariff filing contemplated by 19.18(3)"b" may be filed outside of a general rate case proceeding.

MidAmerican requests clarification of the schedule under this paragraph. MidAmerican asks whether the Board will issue a decision on the proposed adjustment mechanism within 30 days, as implied by the requirement that an

annual tariff filing be made by April 1 with an effective date of May 1. MidAmerican asks when the prudence of the expenditures would be determined by the Board.

MidAmerican states that no rationale was provided in the proposed rulemaking or order for the April 1 filing date and the May 1 effective date. MidAmerican suggests that the utility be allowed to make the tariff filing any time throughout the year with recovery to be effective for any 12 month period.

In additional comments, MidAmerican states that the costs recovered through an automatic adjustment mechanism would be rolled into base rates during a subsequent general rate case. MidAmerican states that the costs will be subject to review, including a review for prudence, when obtaining Board approval for an automatic adjustment under proposed paragraph 19.18(1)"a" and when a tariff filing is approved under paragraph 19.18(1)"b." MidAmerican also states that the Board will be able to review the prudence of costs during the annual reconciliation. MidAmerican requests the Board clarify the procedures if its understanding is not correct.

MidAmerican states that at the oral presentation it recommended an additional change be made to paragraph 19.18(1)"b." MidAmerican suggests that the inclusion of the January 1, 2011, date in the paragraph casts doubt on the eligibility of costs to meet current rules. MidAmerican recommends a specific date not be included in the rule that is adopted.

MidAmerican responds to a question about formal staff reports like staff prepares in transmission franchise cases. MidAmerican states that it has not proposed such reports, but has no objection to filing such reports if the Board decides the reports would be helpful. If formal reports are filed and then form the basis of a Board inquiry docket, MidAmerican requests the Board allow utilities to review the reports for factual errors before they are used in the docket.

3. Black Hills Energy supports this paragraph with the following insertion: "The government entity mandate or action, including compliance with an integrity or safety plan adopted by the gas utility to comply with any such mandate or action, that results in the gas utility project … ."

Black Hills Energy suggests that the inserted language is important as federal and state rules evolve in the areas of integrity and safety. Black Hills Energy states that DIMP rules may provide guidance but the utility must devise its own plan to comply with the DIMP rules. Black Hills Energy states that there may never be formal approval of the compliance plan, only enforcement if the company does not comply with the plan or DIMP rules. The insertion is to address this issue.

Staff Analysis

It is Staff's understanding that the Board will approve the costs to be recovered through the automatic adjustment mechanism within the 30 days provided for in the rule. This is one reason that the costs to be recovered should be limited to the eligibility criteria as proposed. This will allow Board staff and Consumer Advocate sufficient time to review the costs since the utility will be required to provide information about the investment and the government mandate that required the utility to incur the investment. Board staff inspectors should be aware of the project involved and be able to advise staff as to costs associated with the investment and the reasons for the investment.

Staff believes the Board should consider the approval of a factor based upon the eligible investment as a preliminary prudence decision; however, the inclusion of the prudence of the investment could also be made an issue in the utility's next rate case. Staff believes the tariff filing can be made outside of a general rate case anytime the utility is required to incur investment costs that meet the eligibility requirements. Staff has no problem with allowing the utility to file a 30-day tariff for an automatic adjustment mechanism recovery any time throughout the year. Recovery would then be over the succeeding 12-month period after the effective date of the tariff. Only one filing could be made within a 12-month period.

Staff has some concerns about the language that Black Hills Energy proposes to add, "<u>including compliance with an integrity or safety plan adopted by the gas utility to comply with any such mandate or action</u>." The language seems to be open to interpretation and would require some explanation and back up information from the utility. If the Board decides to add this language, the staff recommends the Board also add an additional requirement in subparagraph 19.18(3)"b"(6) that requires the utility to explain the relationship between the government mandate and the investment made based upon the integrity or safety plan. The language would be as follows:

> <u>(6) If the capital infrastructure investment to be included in the automatic adjustment mechanism is based upon an integrity or safety plan adopted in compliance with state or federal natural gas pipline safety regulations, describe the relationship of the capital infrastructure investment to the integrity or safety plan and the relationship of the integrity or safety plan to a specific state or federal regulations. Provide the date the state or federal regulation was adopted, any relevant compliance dates, and the date the integrity or safety plan was adopted by the utility and how the integrity or safety plan was developed.</u>

Board Approval and/or Comments

I am ok with adding BH's suggested language as long as staff's recommended paragraph (6) is also added. RBB 9-7-11

OK to allow filing any time during the year and only allow one filing in a 12-month period. Recovery over the succeeding 12-mo. period is fine. Definitely need to include paragraph (6) with BH's suggested language. LJ 9-9-11

APPROVED

/s/ Elizabeth S. Jacobs *9-9-11*
Date

/s/ Darrell Hanson *9-9-11*
Date

/s/ Robert B. Berntsen *9-7-11*
Date

c. The utility shall calculate the rates for the recovery of the capital infrastructure investment through the automatic adjustment mechanism over the 12-month period from May 1 through April 30 of the next year, unless otherwise ordered by the board. The capital infrastructure investment factor shall be calculated by taking the total eligible investment costs for the prior calendar year divided by the actual prior calendar year's sales volumes with the necessary degree day adjustments.

1. IPL suggests that some clarification may be needed for use of the actual prior calendar year sales with the necessary degree day adjustment. IPL questions how the necessary degree day adjustment may be determined and how the determination might affect the utilization of weather normalization I future general rate case proceedings. IPL suggests amending the paragraph to specify that the methods for degree day adjustments used in the most recent purchased gas adjustment (PGA) filings should be used in this calculation. IPL suggests that use of the volumes from the last annual PGA filing to remove the burden of recalculating the weather normalization amounts. IPL states that this approach is appropriate since the costs and revenues will be reconciled. IPL states that use of this method would be for the automatic adjustment mechanisms and would not necessarily be appropriate for future rate cases.

IPL suggests adding the following language at the end of the proposed paragraph 19.18(3)"c":

> The degree day adjustments shall be the same as that utilized by the utility in the most recent PGA annual filings. This degree day adjustment shall not be determinative of any weather normalization adjustment in any future rate case.

2. Black Hills Energy suggests that utilities use their current rate design to calculate the rates, rather than utilizing and implementing a separate rate design with potentially different HDDs.

Staff Analysis

Staff believes there should be some flexibility provided to the utilities in determining what volumes and degree day adjustments to use in calculating the automatic adjustment factor. Staff does not agree with Consumer Advocate that there needs to be a standard formula. Each utility should have some flexibility in determining what volumes to use in the rate calculation. Rather than mandate a specific set of volumes and degree days, staff recommends the Board modify IPL's proposed language to reflect this flexibility. The revision recommended by staff is as follows:

> A utility may use the degree day adjustment that the utility utilized in the most recent PGA annual filings or any other appropriate degree day adjustment. This degree day adjustment shall not be determinative of any weather normalization adjustment in any future rate case.

Board Approval and/or Comments

OK with staff rec. LJ

APPROVED

/s/ Elizabeth S. Jacobs *9-9-11*
Date

/s/ Darrell Hanson *9-9-11*
Date

/s/ Robert B. Berntsen *9-7-11*
Date

d. The utility shall file an annual reconciliation on June 1 of each year after the initial year in which the automatic adjustment mechanism is implemented that reconciles the actual revenue recovered through the automatic adjustment mechanism with the costs of the eligible capital infrastructure investments proposed to be recovered. The reconciliation shall be for the 12-month period May 1 through April 30. Any over-recoveries or under-recoveries from the reconciliation shall be recovered over the 10-month period from July 1 through April 30.

1. MidAmerican states that there are no rules proposed that clarify the types of information or support that are expected to be included in the reconciliation filing. MidAmerican asks whether the annual reconciliation include a determination of the eligibility of the costs for inclusion in the automatic adjustment mechanism, an evaluation of the prudence of the costs included, or both. MidAmerican states that no rationale was included for the filing of the reconciliation on June 1 with over an under recoveries to be recovered over the ten-month period from July 1 to April 30. MidAmerican recommends that the utilities file reconciliations within 60 days following the end of any annual reconciliation period with over and under recoveries to be recovered over the following ten-month period.

Staff Analysis

Staff does not believe that clarification is necessary for the information that is required in the reconciliation. The utility will file the amount of revenue recovered and the amount of costs that were to be recovered and the difference, whether more or less, will then be included in the automatic adjustment factor over the next ten months. Staff agrees with MidAmerican that the utility should have 60 days after the end of the 12-month recovery period to file the reconciliation. Staff does not believe it is appropriate to consider prudence in this reconciliation filing since it will only compare costs with revenue recovered.

Board Approval and/or Comments

OK LJ

APPROVED

/s/ Elizabeth S. Jacobs 9-9-11
Date

/s/ Darrell Hanson 9-9-11
Date

/s/ Robert B. Berntsen *9-7-11*
Date

In reviewing the proposed rule and the suggested changes, staff is concerned that the rule may not provide an explanation of how an automatic adjustment mechanism would work each year that it is in effect and then how recovery under the mechanism ends. In an attempt to provide this explanation, staff recommends the Board revise the proposed rule by adding a new paragraph. This paragraph will explain that once an automatic adjustment mechanism is implemented recovery of the return of and return on the investment for that year will continue each year until final rates in a subsequent general rate proceeding are effective. The automatic adjustment mechanism will then return to zero.

The utility will be expected to file a proposed tariff each year to implement a new rate that will continue recovery of the previous year's eligible capital investment and include any additional eligible capital investment, if any. Each year's reconciliation will be an adjustment to each year's rate, if an adjustment is necessary.

Staff recommends the following paragraph be added:

> e. Recovery of a return on and return of capital infrastructure investment that is eligible for recovery pursuant to an automatic adjustment mechanism approved under this rule shall continue until final rate are approved by the Board in the next general rate case proceeding. To continue recovery, a utility shall file a proposed tariff each year. Once final rates approved by the Board in the next general rate case proceeding are effective, the automatic adjustment mechanism will return to zero.

Board Approval and/or Comments

APPROVED

/s/ Elizabeth S. Jacobs *9-9-11*
Date

/s/ Darrell Hanson *9-9-11*
Date

/s/ Robert B. Berntsen *9-7-11*
Date

Adopt the following **new** rule 199—19.18(476):

199—19.18(476) Capital infrastructure investment automatic adjustment mechanism.

19.18(1) Eligible capital infrastructure investment. A rate-regulated natural gas utility may file for board approval a capital infrastructure investment automatic adjustment mechanism to allow recovery of certain costs from customers. To be eligible for recovery through the capital infrastructure investment automatic adjustment mechanism, the costs shall either:

a. Meet the following criteria:

(1) The costs are beyond the direct control of management;

(2) The costs are subject to sudden, important change in level;

(3) The costs are an important factor in determining the total cost of capital infrastructure investment to serve customers; and

(4) The costs are readily, precisely, and continuously segregated in the accounts of the utility; or

b. Be costs for a capital infrastructure investment which:

(1) Does not serve to increase revenues by directly connecting the infrastructure replacement to new customers;

(2) Is in service but was not included in the gas utility's rate base in its most recent general rate case; and

(3) Replaces or modifies existing infrastructure required by state or local government action~~, is required for safety,~~ or is required to meet state or federal natural gas pipeline safety regulations ~~that become effective after January 1, 2011~~.

19.18(2) Determination of recovery factor. The utility may recover a rate of return and depreciation expense associated with eligible capital infrastructure investments described in subrule 19.18(1). The allowed rate of return shall be the average cost of debt from the utility's last general rate review proceeding. Depreciation expense shall be based upon the depreciation rates allowed by the board in the utility's last general rate review proceeding.

19.18(3) Recovery procedures.

a. To recover capital infrastructure investment costs that meet the criteria in

paragraph 19.18(1)"a" through an automatic adjustment mechanism, the utility is required to obtain prior board approval of the automatic adjustment mechanism. The utility shall file information in support of the proposed automatic adjustment mechanism that includes:

(1) A description of the capital infrastructure investment and the costs that are proposed to be recovered through the automatic adjustment mechanism;

(2) An explanation of why the costs of the capital infrastructure investment are beyond the control of the utility's management;

(3) An exhibit that shows the changes in level of the costs of the capital infrastructure investment that are proposed to be recovered, both historical and projected;

(4) An explanation of why these particular capital infrastructure investment costs are an important factor in determining the total cost of capital infrastructure investment to serve customers;

(5) A description of proposed recovery procedures, if different from the procedures described in paragraphs 19.18(3)"c" and "d";

(6) The length of time that the automatic adjustment mechanism will be in place.

b. Recovery of capital infrastructure investment costs that meet the requirements in paragraph 19.18(1)"b" may be made by the utility by filing ~~annually on or before April 1 of each year~~ a proposed tariff with ~~an~~ a 30-day effective date ~~of May 1 or later~~. Only one tariff filing to recover capital infrastructure investment costs shall be made in a 12-month period. The utility shall file information in support of the proposed automatic adjustment rates that includes:

(1) The government entity mandate or action that results in the gas utility project and the purpose of the project, or the safety-related reason requiring the project.

(2) The location, description, and costs associated with the project.

(3) The cost of debt and applicable depreciation rates from the utility's last general rate review proceeding.

(4) The calculations showing the total costs that are eligible for recovery and the rates that are proposed to be implemented.

(5) The utility shall provide supporting documentation, including but not

limited to work orders and journal entries, to the board staff or the office of consumer advocate upon request.

(6) If the capital infrastructure investment to be included in the automatic adjustment mechanism is based upon an integrity or safety plan adopted in compliance with state or federal natural gas pipline safety regulations, describe the relationship of the capital infrastructure investment to the integrity or safety plan and the relationship of the integrity or safety plan to a specific state or federal regulations. Provide the date the state or federal regulation was adopted, any relevant compliance dates, and the date the integrity or safety plan was adopted by the utility and how the integrity or safety plan was developed.

c. The utility shall calculate the rates for the recovery of the capital infrastructure investment through the automatic adjustment mechanism over the 12-month period beginning from the effective date of the tariff, unless otherwise ordered by the board. The capital infrastructure investment factor shall be calculated by taking the total eligible investment costs for the prior calendar year divided by the actual prior calendar year's sales volumes with the necessary degree day adjustments. The utility may also use the degree day adjustment that the utility utilized in the most recent purchased gas adjustment annual filing or any other appropriate degree day adjustment. The degree day adjustment shall not be determinative of any weather normalization adjustment in any future rate case.

d. The utility shall file an annual reconciliation ~~on June 1 of~~ within 60 days of the end of the 12-month period each year after the initial year in which the automatic adjustment mechanism is implemented that reconciles the actual revenue recovered through the automatic adjustment mechanism with the costs of the eligible capital infrastructure investments proposed to be recovered. The reconciliation shall be for the 12-month period beginning with the effective date of the tariff ~~May 1 through April 30~~. Any over-recoveries or under-recoveries from the reconciliation shall be recovered over the 10-month period from the effective date of any adjustment required by the reconciliation ~~July 1 through April 30~~.

e. Recovery of a return on and return of capital infrastructure investment that is eligible for recovery pursuant to an automatic adjustment mechanism approved under this rule shall continue until final rate are approved by the Board in the next general rate case proceeding. To continue recovery, a utility shall file a proposed tariff each year. Once final rates approved by the Board in the next general rate case proceeding are effective, the automatic adjustment mechanism will return to zero.